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SUBJECT: TURKEY: UNPOPULAR GAS PRICE INCREASES GO FORWARD

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¶1. (SBU) Summary. On November 1, the Turkish gas import monopoly BOTAS announced a 22.5% price increase in gas for households and 22% for industry. This is the fifth gas price increase in 2008 and brings the total gas price increase to over 70% so far this year. At a press conference on November 3, Energy Minister Guler said the implementation of an automatic pricing mechanism for electricity and gas left the GOT no options but to allow prices to increase, and also blamed the recent lira devaluation. Under the new pricing mechanism, only the Prime Minister can block a price increase. However, BOTAS' tenuous financial health also forced the GOT to allow the increase. This was a tough decision for the GOT in advance of March 2009 local elections and should help reassure investors that the GOT no longer wants to meddle in electricity and gas pricing decisions. End summary.

¶2. (SBU) BOTAS's announcement to raise gas prices by 22.5% for households and 22% for the industry is the fifth gas price increase since the beginning of 2008. In January, the increase for households was 7.4% and industry 6.5%; in June, 7.4% and 8.3%; in August, 16.88% and 18.77%; in October, 4.55% and 4.69% respectively. The cumulative increase in gas prices since January 2008 was 72.7% for households and 74.9% for the industry. Since about half of Turkey's electricity is produced with natural gas, the gas price increase is expected to bring about a double digit increase in electricity prices in January 2009. (Note: Electricity prices have already risen about 60% this year. End note.)

¶3. (SBU) Turkey implemented the automatic pricing mechanism July 1, 2008. This mechanism is basically a cost pass-through mechanism and an important step in liberalizing gas prices in Turkey. The price increases have been dramatic because electricity (and gas) prices were held constant from 2002-2007. The increases earlier in the year were aimed at shoring up the financial health of the sector prior to privatization. Surprisingly, the large gas price increase comes only months before scheduled local elections in March 2009. According to the formula, gas prices are adjusted monthly while electricity prices are adjusted quarterly. The price changes go forward automatically, unless the Prime Minister intervenes.

¶4. (SBU) Energy Minister Guler and BOTAS Chairman Saltuk Duzyol held a press conference on November 3 to respond to criticism over gas price increases. Guler said the GOT had no control over the world oil prices and fluctuating exchange rates and was taking the steps required by Turkey's automatic pricing mechanism. Guler added that the oil prices are now in a downward trend, and without further depreciation of the lira, gas prices would drop in the in the first quarter of 2009. Duzyol noted the 33% devaluation in lira against USD in the past month, and compared favorably the 150% increase in world oil prices in the past 10 months to BOTAS action to increase gas prices by 73% for households and 75% for industry. Duzyol

claimed that the gas price increases in Turkey remained below the increases in European countries.

15. (SBU) Another impetus for this gas price increase is the strained financial situation of BOTAS. The Government of Turkey is one of the largest debtors to BOTAS. The city of Ankara owes BOTAS over USD 1 billion. The city had hoped to pay its debt using the proceeds from privatization of the city gas distribution network. Unfortunately, the winning bidder recently withdrew from the deal because his promised bank financing was withdrawn. We have also heard that BOTAS owes money to the Treasury. Electricity generators, like Unit Energy Systems S.A., have told us they have received letters from the Treasury demanding that payments owed to BOTAS for gas purchases be sent to the Treasury to resolve BOTAS's debts.

16. (SBU) Comment: The automatic pricing mechanism is new and investors are waiting to see how it will be implemented. This latest large and unpopular gas price increase, coming shortly before an important local election, should help instill confidence in investors that the GOT no longer wants to meddle in pricing electricity and gas. Additionally, Turkey's market liberalization is continuing. One of the criticisms we hear from investors who are considering entering the market is the unpredictability of future electricity and gas prices. Turkey has a wholesale spot market for electricity but it represents less than 20% of the total electricity market. Because of the tight electricity supply, the price in this market is higher than the price between state-owned generators and distributors. According to Ministry of Energy expert Ozturk Sevintop, Turkey will create a futures market for electricity in 2011 to give greater predictability to future utility prices. This also may help bring investors into the sector. End comment.

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